REPORT OF EXAMINATION
OF THE

MERCURY CASUALTY COMPANY

AS OF
DECEMBER 31, 2003

Participating State
and Zone:

California

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Los Angeles, California
October 22, 2004

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition (EX4) Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable John Morrison
Secretary, Zone IV-Western
Commissioner of Insurance and Securities
Montana Department of Insurance
Helena, Montana

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman and Commissioners:

Pursuant to your instructions, an examination was made of the

MERCURY CASUALTY COMPANY

(hereinafter also referred to as the Company) at its branch office located at 4484 Wilshire Boulevard, Los Angeles, California 90010. The Company's statutory home office is located at 555 West Imperial Highway, Brea, California 92821.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2000. This examination covers the period from January 1, 2001 through December 31, 2003. This examination was conducted pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2003, as deemed necessary under the circumstances.

This examination was conducted concurrently with examinations of the Company's wholly-owned subsidiaries, Mercury Insurance Company and California General Underwriters Insurance Company, Inc., and of the Company's affiliate, California Automobile Insurance Company.

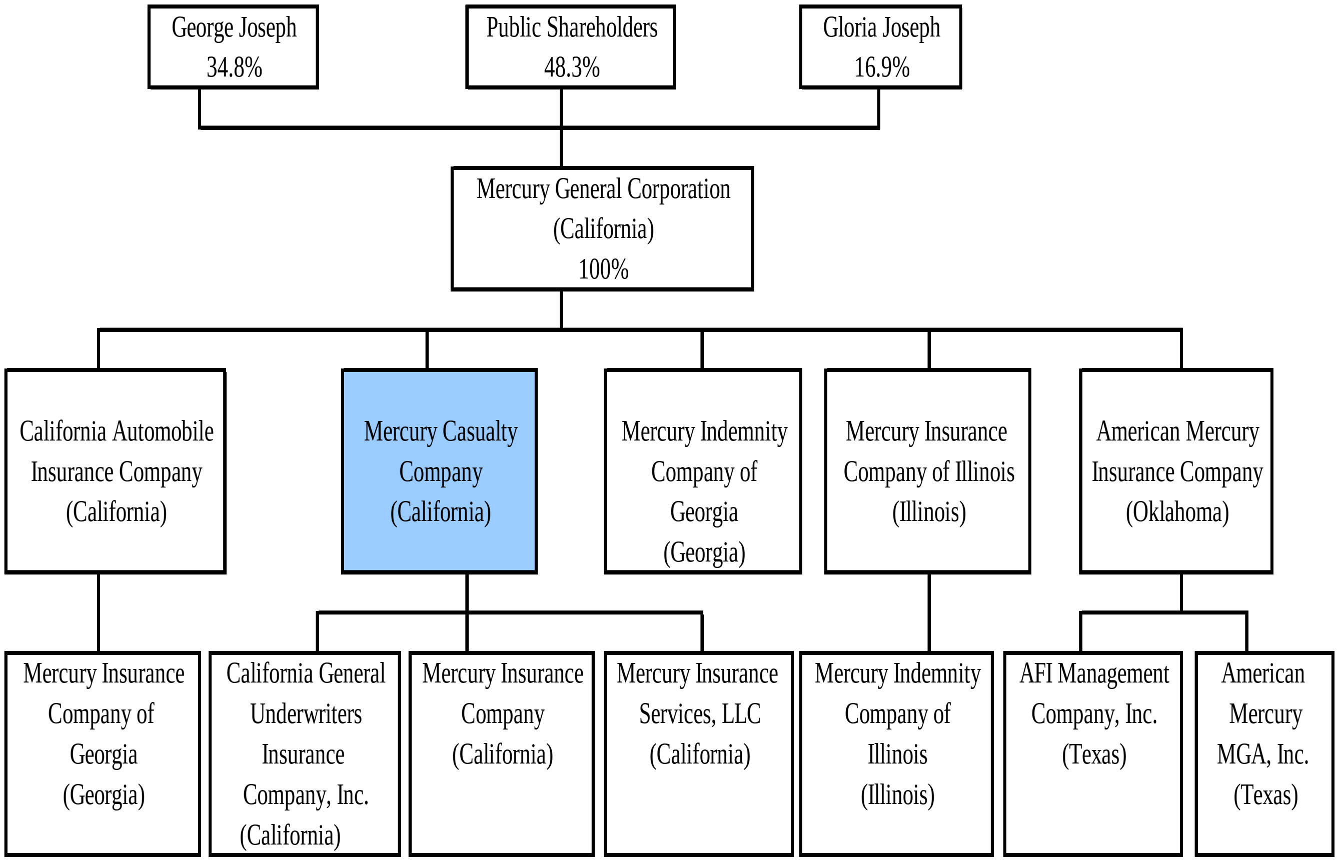
In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; loss experience; and sales and advertising.

COMPANY HISTORY

The Company was incorporated under the laws of the State of California on January 6, 1961, and commenced business on April 6, 1962. During the examination period, the Company paid cash dividends to its parent in the amount of $211 million.

MANAGEMENT AND CONTROL

The Company is a wholly-owned subsidiary of Mercury General Corporation (MGC). The controlling stockholders, George Joseph and Gloria Joseph, own 34.8% and 16.9%, respectively, of the stock of MGC, with the remaining 48.3% held by public shareholders. The following organizational chart depicts the interrelationships of the companies within the holding company system:


George Joseph 34.8%
Public Shareholders 48.3%
Gloria Joseph 16.9%
Mercury General Corporation (California) 100%
California Automobile Insurance Company (California)
Mercury Casualty Company (California)
Mercury Indemnity Company of Georgia (Georgia)
Mercury Insurance Company of Illinois (Illinois)
American Mercury Insurance Company (Oklahoma)
Mercury Insurance Company of Georgia (Georgia)
California General Underwriters Insurance Company, Inc. (California)
Mercury Insurance Company (California)
Mercury Insurance Services, LLC (California)
Mercury Indemnity Company of Illinois (Illinois)
AFI Management Company, Inc. (Texas)
American Mercury MGA, Inc. (Texas)

Management of the Company is vested in a ten-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2003 follows:

Directors

Name and Residence	Principal Business Affiliation
Nathan Bessin Los Angeles, California	Senior Partner J. Arthur Greenfield & Company
Bruce A. Bunner Weston, Connecticut	President Financial Structures, Ltd.
Michael D. Curtius Carlsbad, California	Executive Consultant Mercury General Corporation
Richard E. Grayson Murrieta, California	Retired
George Joseph Los Angeles, California	Chairman and Chief Executive Officer Mercury General Corporation
Charles E. McClung Carlsbad, California	Chairman McClung Insurance Agency
Donald P. Newell Rancho Santa Fe, California	Senior Vice President and Secretary SCPIE Holdings, Inc.
Bruce E. Norman Los Angeles, California	Vice President of Marketing Mercury General Corporation
Donald R. Spuehler Los Angeles, California	Retired Partner Law Firm of O'Melveny & Meyers, LLP
Gabriel Tirador Los Angeles, California	President Mercury General Corporation

Principal Officers

Name	Title
George Joseph	Chairman, Chief Executive Officer and Treasurer
Gabriel Tirador	President
Cooper Blanton, Jr.	Executive Vice President
Judy Walters	Vice President, Corporate Affairs and Corporate Secretary
Theodore Stalick	Vice President and Chief Financial Officer

Management Agreements

Management Agreement: The Company operates under a management agreement with Mercury Insurance Services, LLC (MIS), a subsidiary of the Company. Prior to January 1, 2001, these services were provided by Mercury General Corporation. Under this agreement, MIS performs all operating functions such as marketing, underwriting, rating, policy issuance, claims, data processing, and pays all the operating expenses including, but not limited to rent, supplies, salaries, legal and claim adjustment expenses. The Company directly pays for losses, premium taxes, audit fees, and various fees and assessments. Management fees are based on actual expenses incurred for services provided to the Company. The California Department of Insurance (CDI) approved this agreement on January 1, 2001. The Company paid the following fees during the examination period:

Year	Amounts
2001	$77,717,164
2002	$82,623,088
2003	$99,501,913

The Company also operates under a premium collection and loss payment arrangement with its two affiliates, Mercury Insurance Company and California Automobile Insurance Company. Under the arrangement, the Company collects the premium and pays claims and commissions on behalf of the other companies. The net amount is settled on a monthly basis. Interest earned on the daily excess cash is allocated among the three companies based on net premiums collected each month. An agreement that governs this arrangement is being drafted and will be submitted to the CDI for approval as required by California Insurance Code Section 1215.5.

Tax Allocation Agreement: The Company and its ultimate parent file a consolidated federal income tax return under the terms of a Tax Allocation Agreement. The Company's tax liability, pursuant to the agreement, is the same as it would have been had it filed on a separate stand-alone basis.

TERRITORY AND PLAN OF OPERATION

The Company is licensed as a multiple line fire and casualty insurer in the states of Arizona, California, Florida, New York, Nevada, Texas, Virginia and Washington. Automobile business accounts for approximately 77% of direct premium written, homeowners accounts for approximately 19% and various property coverages account for the balance. Business is produced by approximately 1,000 agents. The agents, most of whom also represent one or more competing insurance companies, are independent contractors selected and appointed by the Company. In 2003, the Company wrote direct premiums of $669 million, with $644 million written in California, $16 million written in New York and $9 million written in Washington.

The Company's headquarters is in Brea, California. The Company has branch offices in the following cities:

Anaheim	Brea	Los Angeles	Morgan Hill
Rancho Cordova	Rancho Cucamonga	San Clemente	San Diego
Santa Ana	Valencia	Westlake Village	

REINSURANCE

Assumed

The Company assumes business, primarily private passenger and commercial auto liability, from seven affiliates pursuant to six reinsurance treaties.

Type of Contract and Effective Date	Name of Ceding Company	Terms	Assuming Company's Maximum Limits
Excess Casualty August 1, 2000	Mercury Insurance Company of Georgia Mercury Indemnity Company of Georgia Mercury Insurance Company of Illinois Mercury National Insurance Company	Ceding company retains the first $100,000 and any amount over $1 million for each loss occurrence Lines of coverage: Private Passenger Auto Liability, Personal Umbrella Liability	Up to $1 million excess of $100,000 per occurrence
Reinsurance Agreement	Mercury Insurance Company of Georgia Mercury Indemnity Company of Georgia Mercury Insurance Company of Illinois Mercury National Insurance Company	Ceding company retains the first $25,000 Line of coverage: Homeowners	Up to $250,000 excess of $25,000 per occurrence $1.5 million for each company in any one calendar year.
100% Quota Share January 1, 2001	Mercury Insurance Company of Florida	100% Quota share for all lines	100% ultimate net loss arising out of each occurrence
100% Quota Share June 15, 2002	Mercury County Mutual Insurance Company	100% Quota share for business written by Mercury's independent agents Line of coverage: Private Passenger Automobile	100% ultimate net loss arising out of each occurrence
Inter-company Reinsurance Agreement January 1, 2003	American Mercury Insurance Company	Ceding company retains the first $250,000 per occurrence Lines of coverage: General Liab, Professional Liab, Commercial Auto Liab, Comprehensive Personal Liab, Boat Owners Liab, Fire & Allied Lines	Up to $250,000 per occurrence. $2.5 million in any one calendar year
Excess Casualty June 15, 2003	American Mercury Insurance Company	Ceding company retains the first $100,000 per occurrence Lines of coverage: Private Passenger Auto Liability written in the state of Georgia	$1 million per occurrence

Ceded

The Company is a party to a multiple line excess of loss reinsurance agreement with Swiss Reinsurance America Corporation (Swiss Re). The agreement, effective January 1, 2002, covers all property, non-owned automobile liability and non-automobile liability lines of business. The Company is also a party to a personal umbrella liability quota-share contract. This contract, effective May 1, 2003, is a 33% quota share up to $2 million per occurrence. The retentions and limits in effect are set forth as follows:

Type of Contract	Name of Reinsurer	Company's Retention	Reinsurer's Maximum Limits
Multiple Line Excess of Loss Cover	Swiss Reinsurance America Corporation	1st Excess of Loss: $500,000 excess of $500,000 per occurrence 2nd Excess of Loss: $1 million excess of $1 million per occurrence 3rd Excess of Loss: $3 million excess of $2 million per occurrence	Per occurrence limits: 1st layer – $1.5 million property, $500,000 casualty 2nd layer - $3 million property, $1.0 per million casualty 3rd layer - $6 million property, no casualty coverage
Personal Umbrella Liability Quota Share	Swiss Reinsurance America Corporation	67% Company retention	33% of $2 million per occurrence 150% of the Gross Earned Premium during each "Agreement Year" in the aggregate.

The following deficiencies were noted in the aforementioned treaty with Swiss Re:

1. The insolvency clause in the treaty with Swiss Re did not meet the requirements of California Insurance Code (CIC) Section 922.2(a) (2).
2. The offset clause in the treaty with Swiss Re did not meet CIC requirements. The California Department of Insurance requires that items that may be offset must be expressly stated and cannot include words such as "otherwise" or "etc".

It is recommended that the Company take immediate steps to correct the aforementioned deficiencies. The insolvency clause must be amended to comply with CIC 922.2 in order for the Company to receive reinsurance credit in its future financial statements.

ACCOUNTS AND RECORDS

This examination experienced some minor difficulties obtaining supporting documentation for certain balance sheet accounts. It is recommended that the Company maintain documentation to support all financial statement accounts. The documentation should be prepared in sufficient detail as to allow for a full and complete audit trail from the Annual Statement to individual record.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2003

Underwriting and Investment Exhibit for the Year Ended December 31, 2003

Reconciliation of Surplus as Regards Policyholders
from December 31, 2000 through December 31, 2003

Statement of Financial Condition
as of December 31, 2003

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$616,056,723	$	$616,056,723	(1)
Stocks:				
Preferred stocks	22,461,894		22,461,894	(1)
Common stocks	727,829,954		727,829,954	(1)
Real estate				
Properties occupied by the company	45,533,644		45,533,644	
Cash and short-term investments	112,929,731		112,929,731	(1)
Other invested assets	1,846,313		1,846,313	
Receivable for securities	52,497		52,497	
Investment income due and accrued	9,188,973		9,188,973	
Premiums and considerations:				
Uncollected premiums and agents' balances in the course of collection	98,785,246	2,167	98,783,079	
Reinsurance				
Amounts recoverable from reinsurers	1,083,551		1,083,551	
Funds held by or deposited with reinsured companies	2,333,805		2,333,805	
Net deferred tax asset	28,399,622		28,399,622	
Electronic data processing equipment and software	13,793,319		13,793,319	
Furniture and equipment	11,861,824	11,861,824		
Health care and other amounts receivable	22,034,930		22,034,930	
Other assets nonadmitted	474,037	474,037		
Aggregate write-ins for other than invested assets	1,350,778		1,350,778	
Total assets	$1,716,016,841	$ 12,338,028	$1,703,678,813	

Liabilities, Surplus and Other Funds

Losses		$ 231,019,005	(2)
Reinsurance payable on paid loss and loss adjustment expenses		6,102,715	
Loss adjustment expenses		79,432,771	(2)
Commissions payable, contingent commissions		15,229,999	
Other expenses		869,992	
Taxes, licenses and fees		5,124,601	(3)
Current federal and foreign income taxes		8,117,000	
Unearned premiums		275,245,075	
Advance premiums		14,796,282	
Ceded reinsurance premiums payable		2,337,636	
Drafts outstanding		28,184,552	
Payable to parent, subsidiaries and affiliates		37,303,548	
Aggregate write-ins for liabilities		2,059,011	
Total liabilities		705,822,187	
Common capital stock	$ 10,000,000		
Gross paid-in and contributed surplus	100,774,124		
Unassigned funds (surplus)	887,082,502		
Surplus as regards policyholders		997,856,626	
Total liabilities, surplus and other funds		$1,703,678,813	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2003

Statement of Income

Underwriting Income		
Premiums earned		$ 810,941,653
Deductions:		
Losses incurred	$ 446,331,828	
Loss expense incurred	98,652,354	
Other underwriting expenses incurred	219,956,589	
Total underwriting deductions		764,940,771
Net underwriting gain		46,000,882
Investment Income		
Net investment income earned	$ 33,477,791	
Net realized capital gains	5,354,352	
Net investment gain		38,832,143
Other Income		
Net loss from agents' balances charged off	$ (13,157)	
Finance and service charges not included in premiums	2,067,765	
Aggregate write-ins for miscellaneous income	451,448	
Total other income		2,506,056
Net income before federal income taxes		87,339,081
Federal income taxes incurred		(21,346,000)
Net income		$ 65,993,081

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2002		$ 883,509,863
Net income	$ 65,993,081	
Change in net unrealized capital gain	118,680,296	
Change in net deferred income tax	(1,215,216)	
Change in nonadmitted assets	6,619,601	
Dividends to stockholders	(76,000,000)	
Aggregate write-ins for gains in surplus	269,000	
Change in surplus as regards policyholders		114,346,762
Surplus as regards policyholders, December 31, 2003		$ 997,856,626

Reconciliation of Surplus as Regards Policyholders
from December 31, 2000 through December 31, 2003

	Gain in Surplus	Loss in Surplus	
Surplus as regards policyholders, December 31, 2000, per Examination			$856,400,333
Net income	$ 179,911,708	$	
Net unrealized capital gains	144,234,619		
Change in net deferred income tax	22,029,618		
Change in nonadmitted assets		3,910,959	
Cumulative effect of changes in accounting principles	10,295,107		
Dividends to stockholders		211,000,000	
Aggregate write-ins for losses in surplus		103,800	
Totals	$356,471,052	$215,014,759	
Net increase in surplus as regards policyholders			141,456,293
Surplus as regards policyholders, December 31, 2003, per Examination			$997,856,626

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Bonds, Stocks and Cash and Short-Term Investments

Effective September 3, 2003, the Company terminated its Custodial agreement, and replaced it with a new Custodial agreement. The new agreement is between the Company and BNY Western Trust Company. The Company failed to submit this agreement to the California Department of Insurance (CDI) for review and approval under California Insurance Code (CIC) Section 1104.9. It is recommended that the Company submit this agreement to the CDI for review and approval pursuant to CIC Section 1104.9.

(2) Losses and Loss Adjustment Expenses

The December 31, 2003 for loss and loss adjustment expense reserves were evaluated by a Casualty Actuary from the California Department of Insurance. Based on the analysis performed, the Company's reserve for loss and loss adjustment expense reserves as of December 31, 2003 were deemed reasonable.

(3) Taxes, Licenses and Fees

The CDI made a determination that starting with tax year 1998, the Company began to use premiums received instead of premiums written as the premium tax base. The CDI proposed deficiency assessment for each year was $956,658, $27,652 and $39,665 for years 1998, 1999 and 2000, respectively. The Company filed a Petition for Redetermination while it continued to use premium received instead of premiums written as the premium tax base. The CDI has sent the California State Board of Equalization the above information for further processing. The Company is contesting the CDI proposed deficiency assessments. A hearing on this matter is currently pending.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control-Management Agreement (Page 5): It is recommended that the Company submit a premium collection and loss payment agreement with Mercury Insurance Company, a wholly-owned subsidiary and California Automobile Insurance Company, an affiliate, to the California Department of Insurance for approval as required by California Insurance Code (CIC) Section 1215.5.

Reinsurance-Ceded (Page 8): It is recommended that the Company correct deficiencies noted in its reinsurance agreement to comply with CIC Section 922.2.

Accounts and Records (Page 9): It is recommended that the Company maintain documentation to support all financial statement accounts.

Bonds, Stocks and Cash and Short-Term Investments (Page 13): It is recommended that the Company implement procedures to ensure compliance with CIC Sections 1104.9 and 1215.

Previous Report of Examination

Corporate Records (Page 6): It was recommended that the Company comply with the CIC Section 735 which requires the Company to inform the board members of the receipt of the examination report and enter that fact in the board minutes. The Company complied with this recommendation.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the officers and employees of Mercury Insurance Services, LLC during the course of this examination are hereby acknowledged.

Respectfully submitted,

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Duane Armstrong, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California